Intellectual Property Insurance Coverage: Seven Tips That Every Purchaser Of Defensive IP Coverage Should Know

By Micah E. Skidmore | April 7, 2022

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Intellectual property (IP) insurance coverage is having a moment. The post-pandemic economic recovery has been driven to a large extent by technology startups.[1] For a new tech company, strong IP can provide both a competitive and fundraising advantage. Without the ability to protect that IP, the advantage is limited. Effective and appropriate insurance coverage, however, can both preserve the company's intellectual property and provide its own basis for corporate exceptionalism and exclusivity.

Not all intellectual property is created equal. Neither is IP coverage. Intellectual property insurance coverage policies are manuscripted, meaning the coverage is not written on uniform state-approved forms, but with unique terms and provisions that may vary from policy to policy. Intellectual property coverage may be (1) defensive; (2) offensive; (3) contingent; or (4) some variant of these three. At a very basic level, defensive IP coverage will defend and indemnify the insured against suits alleging infringement, which may include coverage for affirmative inter partes review (IPR) proceedings challenging the validity of the claimant's patent(s) and/or satisfying claims by indemnitees embroiled in litigation over the insured's licensed IP. Offensive IP insurance will cover the insured's enforcement of its own intellectual property, such as affirmative infringement claims against and unlicensed third-party. Contingent IP coverage is like other litigation insurance because it is intended to bracket existing litigation risk by protecting the insured against catastrophic loss in an ongoing IP case. Other variations on these coverages may include residual value insurance, which protects the value of intellectual property assets pledged as collateral for secured loans, or trade secret value insurance, which protects the value of trade secrets in the event of misappropriation.

Litigation risk for IP-heavy businesses can be substantial. Attorneys' fees, expert expenses and other costs in patent infringement litigation may consume a substantial portion of the value of the IP at stake.[2] And the ultimate damages at issue may be catastrophic.[3] Because of the high cost of litigation, defensive IP coverage is, by far, the most prolific IP insurance product available in the market. For those companies who have never purchased defensive intellectual property coverage or for those companies going through a renewal, here are seven key policy terms to consider:

1. **Trigger of Coverage & Notice.** The trigger of coverage is the event described in the policy that must happen before the insured is obligated to give notice and the insurer is required to start paying to defend the insured or an indemnified party. Some policies will specify that the triggering event is a "claim" or "demand" for compensation made by a third-party during the policy period. Other policy wording may include claims and demands, but also a licensing request or other circumstance, which, whether objectively or subjectively, is likely to give rise to a future demand or litigation. Although individual considerations may vary, if the right "circumstance" can warrant the retention of counsel to investigate and preemptively defend against a potential infringement claim, many insureds will prefer a more inclusive trigger of

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coverage, as opposed to waiting for a specific demand before coverage incepts. At the same time, those policyholders, who elect the broader coverage trigger will also need to ensure that timely notice is provided in response to such circumstances and not only in the event of a specific "claim." In either case, policyholders should carefully review and be familiar with the terms defining the trigger of coverage and notice obligations both before and after purchasing a defensive IP insurance policy.

2. **Related Claims Provisions.** Like other "claims made" coverages, some IP insurance provisions, including those embedded in professional or media liability policies, will provide that all "claims" arising out of a common set of facts and circumstances are deemed to be a single claim first made when the earliest of the claims was made. Such provisions may be intended by underwriters to prevent a situation in which multiple policies apply to a single claim. But in the hands of an adverse claims adjuster, these provisions can be manipulated to avoid coverage. For example, a lawsuit in year one, involving bodily injury arising out of a defect in a patented product or an alleged misrepresentation in a disclosure about the insureds' intellectual property, could undermine coverage for a patent infringement lawsuit involving the same IP in year 2—unless the IP policy's "related claims" provision is narrowed. To avoid a situation in which failure to give notice of non-IP litigation under an IP litigation insurance policy results in a potential loss of coverage, "related claims" provisions should be worded to aggregate only claims alleging the insured engaged in infringement of a third-party's intellectual property.
3. **Defense Costs & IPR Proceedings.** A policyholder, who purchases defensive IP insurance coverage, can reasonably expect the policy to cover the cost of defending against allegations that the insured is infringing a third-party's patent, copyright, trademark or other intellectual property. But what if "defending" against a claim of patent infringement involves challenging the validity of the third-party claimant's patent in an IPR proceeding? Will the insured's initiation and affirmative pursuit of an IPR proceeding be considered defensive or outside the scope of the policy's coverage? Brokers, risk managers and counsel advising an insured on the purchase of IP coverage should carefully review policy terms to ensure that the cost of pursuing an IPR proceeding or other "affirmative" actions taken to defend against allegations of IP infringement, including counterclaims or third-party actions, are not excluded from coverage. Policyholders should also avoid, where possible, those exclusions that would preclude coverage for counterclaims or cross-claims initiated by an insured in defending otherwise covered IP litigation.
4. **Infringement Withdrawal Expenses.** Defensive IP insurance policies will typically insure "loss," including defense costs and amounts payable to a third-party claimant as damages in satisfaction of a judgment or settlement. But beyond compensation for a plaintiff or indemnitee, a policyholder found liable for infringement may also incur substantial expenses to become compliant by, among other things, withdrawing any infringing product from the market. These costs may include transportation, labor, storage, labelling, and public relations. To avoid potential disputes over whether such expenses qualify as "damages," those considering purchasing IP coverage and exposed to this risk should review a prospective policy's terms with an eye toward coverage for infringement withdrawal expenses.
5. **Fee Awards.** Depending on the nature of the intellectual property claim against the insured, the plaintiff/claimant may be entitled to recover attorney's fees, costs or other expenses against the insured. For the reasons articulated above, such fee awards may be substantial. Prospective purchasers of IP insurance coverage should review policies to confirm that coverage is extended for an adversary's award of fees or costs, particularly where the policy otherwise addresses the recovery of the insured's fees and costs in subrogation.
6. **Contractual Liability Exclusions.** Intellectual property risk for potential defendants and insureds exists on at least two levels. For example, a non-practicing entity may pursue

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statutory claims for infringement of a patent, copyright or trademark against a practicing policyholder without establishing any privity or other relationship between plaintiff and defendant. Alternatively, a licensee may, by exceeding the constraints of a limited license, incur both statutory and contractual liability to a licensor. An insured may also incur liability through a contractual promise to indemnify a licensee accused of infringement by a third-party. Despite the potential overlap between infringement and contractual liability, some IP insurance policies include exclusions purporting to eliminate coverage for any claim arising from any breach, repudiation, termination or suspension of any written contract, license or other agreement by the insured. In evaluating coverage terms, policyholders should carefully scrutinize contractual liability exclusions (1) to avoid potential conflicts with express coverage for liability to indemnified parties; and (2) to ensure consistency with the parties' intent to provide coverage for patent infringement liability, even when framed in terms of a breach of contract.

7. **Bad Conduct Exclusions.** Like customary D&O policies, many defensive IP insurance policies include exclusions for claims (1) arising from an Action or Licensing Request caused or contributed to by the Insured's actual or alleged dishonesty, fraudulent, malicious or criminal conduct; and/or (2) arising from the Insured gaining any profit or advantage to which the insured is not legally entitled. While these kinds of exclusions may be appropriate for a traditional D&O policy, such terms have no place in an IP insurance policy to the extent that they conflict with and potentially eviscerate coverage for infringement claims that necessarily require as elements of proof some evidence that the defendant insured engaged in acts of unauthorized infringement. At a minimum, the policyholder should insist upon exceptions, also typical of D&O insurance, for the defense of otherwise covered claims and requiring a final, non-appealable adjudication of the excluded conduct.

No insurance policy is perfect. Nor will underwriters always agree on every policy enhancement or modification in terms requested by an insured. But focusing on the foregoing terms will provide policyholders an opportunity maximize defensive IP insurance coverage in the event of substantive underlying infringement litigation. If you have any questions about an intellectual property insurance coverage or about insurance recovery in general, please contact one of Haynes Boone's Insurance Recovery Practice Group partners listed below.

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[1] *See, e.g.,* Yusuf Berkan Altun, *Pandemic Fuels Global Growth of Entrepreneurship and Startup Frenzy*, Forbes (Apr. 9, 2021), *available at* https://www.forbes.com/sites/forbestechcouncil/2021/04/09/pandemic-fuels-global-growth-of-entrepreneurship-and-startup-frenzy/?sh=7eb8fcb97308; Howard Schneider, *Soaring U.S. business starts in pandemic show new normal evolving*, Reuters (Oct. 28, 2021), *available at* https://www.reuters.com/business/soaring-us-business-starts-pandemic-show-new-normal-evolving-2021-10-28/; Andrea Hsu, *New businesses soared to record highs in 2021. Here's a taste of one of them*, NPR (Jan. 12, 2022), *available at* https://www.npr.org/2022/01/12/1072057249/new-business-applications-record-high-great-resignation-pandemic-entrepreneur.

[2] *See generally* AIPLA, Report of the Economic Survey (2021).

[3] Britain Eakin, *Intel Hit With $2.18B Jury Verdict In VLSI Patent Fight*, Law360 (Mar. 2, 2021), *available at https://www.law360.com/articles/1360627*.

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